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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE
COMMISSION,

No. C-08-4238 EMC

Plaintiff,

v.

**COURT'S PROPOSED JURY
INSTRUCTIONS**

RAJ P. SABHLOK and MICHAEL C.
PATTISON,

(August 9, 2010)

Defendants.

United States District Court
For the Northern District of California

**JURY INSTRUCTION NO. 1 -- DUTY OF JURY (COURT READS AND PROVIDES
WRITTEN INSTRUCTIONS AT END OF CASE)**

Members of the Jury: Now that you have heard all of the evidence [and the arguments of the attorneys], it is my duty to instruct you as to the law of the case.

[A copy of these instructions will be sent with you to the jury room when you deliberate.]

You must not infer from these instructions or from anything I may say or do as indicating that I have an opinion regarding the evidence or what your verdict should be.

It is your duty to find the facts from all the evidence in the case. To those facts you will apply the law as I give it to you. You must follow the law as I give it to you whether you agree with it or not. And you must not be influenced by any personal likes or dislikes, opinions, prejudices, or sympathy. That means that you must decide the case solely on the evidence before you. You will recall that you took an oath to do so.

In following my instructions, you must follow all of them and not single out some and ignore others; they are all important.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.1C.

Court Comments: No objection by the parties.

JURY INSTRUCTION NO. [2] – CLAIMS AND DEFENSES

To help you follow the evidence, I will give you a brief summary of the positions of the parties:

Plaintiff the Securities and Exchange Commission (the “SEC” or “Commission”) claims that Defendant Michael Pattison violated the federal securities laws. The SEC claims that the defendant participated in a scheme to defraud shareholders of Embarcadero Technologies, Inc. (“Embarcadero”), between 2000 and 2005, while he was the Controller of the company. The SEC also claims that the defendant made, or helped others make, misrepresentations to shareholders and failed to disclose important information about securities called stock options. The SEC alleges that the defendant helped in a scheme to select prices and dates for those stock options, and that the defendant, as the Controller, failed to accurately disclose this practice, or the cost of the practice in Embarcadero’s reports to shareholders. The SEC also alleges that the defendant helped keep the practice from other persons, including Embarcadero’s independent auditors and its outside lawyer, in order to permit the scheme to remain undetected. The SEC claims that the failure to disclose truthfully how options prices were picked, or how they were dated, or how they were accounted for, deprived Embarcadero’s shareholders of important information about their investment in the company’s stock.

The defendant denies the SEC’s claims and contends that, if any accounting errors were indeed made, those errors were made in good faith and not unreasonable in light of many factors, such as the widespread industry confusion over the relevant accounting rules, the language of Embarcadero’s stock plan, his inexperience with public companies and stock options accounting, his reliance on more experienced professionals (including senior management and auditors) and his belief that many others knew of and approved the practice. The defendant claims that he never thought that anyone else was inaccurately accounting for stock options, never intend to help anyone do so, and never actually did help anyone else do so. He claims that there was simply no secret scheme to defraud anyone. Finally, the defendant claims that the supposedly omitted accounting information about the stock options was not important to the shareholders, who had the relevant information.

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Authority: 9th Cir. Model Civil Jury Instruction No. 1.2 (modified).

Court Comments: No objection by the parties; stipulated version drafted by the parties. The Court has made minor changes to the parties' stipulated instruction (*e.g.*, for purposes of consistency).

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**JURY INSTRUCTION NO. [13] – BURDEN OF PROOF –
PREPONDERANCE OF THE EVIDENCE**

When a party has the burden of proof on any claim [or affirmative defense] by a preponderance of the evidence, it means you must be persuaded by the evidence that the claim [or affirmative defense] is more probably true than not true.

You should base your decision on all of the evidence, regardless of which party presented it.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.3.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [3] – WHAT IS EVIDENCE

The evidence you are to consider in deciding what the facts are consists of:

1. the sworn testimony of any witness;
2. the exhibits which are received into evidence; and
3. any facts to which the lawyers have agreed.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.6.

Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. [4] – WHAT IS NOT EVIDENCE

In reaching your verdict, you may consider only the testimony and exhibits received into evidence. Certain things are not evidence, and you may not consider them in deciding what the facts are. I will list them for you:

- (1) Arguments and statements by lawyers are not evidence. The lawyers are not witnesses. What they have said in their opening statements, [will say in their] closing arguments, and at other times is intended to help you interpret the evidence, but it is not evidence. If the facts as you remember them differ from the way the lawyers have stated them, your memory of them controls.
- (2) Questions and objections by lawyers are not evidence. Attorneys have a duty to their clients to object when they believe a question is improper under the rules of evidence. You should not be influenced by the objection or by the court’s ruling on it.
- (3) Testimony that has been excluded or stricken, or that you have been instructed to disregard, is not evidence and must not be considered. In addition sometimes testimony and exhibits are received only for a limited purpose; when I [give] [have given] a limiting instruction, you must follow it.
- (4) Anything you may have seen or heard when the court was not in session is not evidence. You are to decide the case solely on the evidence received at the trial.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.7.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [5] – EVIDENCE FOR LIMITED PURPOSE

Some evidence may be admitted for a limited purpose only.

When I instruct you that an item of evidence has been admitted for a limited purpose, you must consider it only for that limited purpose and for no other.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.8.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [6] – DIRECT AND INDIRECT EVIDENCE

Evidence may be direct or circumstantial. Direct evidence is direct proof of a fact, such as testimony by a witness about what that witness personally saw or heard or did. Circumstantial evidence is proof of one or more facts from which you could find another fact. You should consider both kinds of evidence. The law makes no distinction between the weight to be given to either direct or circumstantial evidence. It is for you to decide how much weight to give to any evidence.

By way of example, if you wake up in the morning and see that the sidewalk is wet, you may find from that fact that it rained during the night. However, other evidence, such as a turned on garden hose, may provide a different explanation for the presence of water on the sidewalk. Therefore, before you decide that a fact has been proved by circumstantial evidence, you must consider all the evidence in the light of reason, experience, and common sense.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.9.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [26] – DRAWING REASONABLE INFERENCES

During the trial, you have heard the attorneys use the term “inference,” and in their arguments they have asked you to infer, on the basis of your reason, experience, and common sense, from one or more established facts, the existence of some other fact.

You may make reasonable inferences based on the facts of the case. An inference is not a suspicion or guess. It is a reasoned, logical conclusion based on some fact or facts that have been shown to exist.

There are times when different inferences may be drawn from facts, whether proved by direct or circumstantial evidence. The plaintiff may ask you to draw one set of inferences, while the defense may ask you to draw another. It is for you, and you alone, to decide what reasonable inferences you will draw.

Court Comments: The parties stipulated to this instruction.

JURY INSTRUCTION NO. [25P] – ADVERSE INFERENCE

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2 You have heard evidence that the defendant refused to answer questions during his January
3 2008 SEC testimony, on the grounds that truthful answers would have tended to incriminate him.
4 Because this is a civil, and not a criminal, proceeding, you are allowed to draw an adverse inference
5 as to what the defendant’s answers would have been had he elected to answer them in 2008. That is,
6 you may, but need not, draw an inference that the defendant’s truthful answers in his 2008 SEC
7 testimony in fact would have tended to incriminate him, if such an inference is warranted by the
8 facts of this case.

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10 Authority: *See SEC v. Colello*, 139 F.3d 674, 677 (9th Cir. 1998) (stating that “[p]arties are free to
11 invoke the Fifth Amendment in civil cases, but the court is equally free to draw adverse inferences
12 from their failure of proof”); *SEC v. Trabulse*, 526 F. Supp. 2d 1001, 1007 n.4 (N.D. Cal. 2007)
13 (noting that defendant refused to answer questions propounded by the SEC pursuant to an
14 investigative subpoena and that, based on that refusal, “[t]he Court is entitled to make an adverse
15 inference, this being a civil action”).

16
17 Court Comments: At the pretrial conference, Judge Breyer held that there would be no reference to
18 the defendant’s invocation of the Fifth Amendment during trial unless the issue became relevant –
19 *e.g.*, if the defendant testified that he had been forthcoming, honest, and direct throughout the
20 proceedings. *See* Docket No. 173 (Tr. at 12). Given this ruling, the Court will not give the
21 requested instruction unless there is testimony by the defendant or his witnesses that makes the issue
22 relevant.

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JURY INSTRUCTION NO. [7] – RULING ON OBJECTIONS

There are rules of evidence that control what can be received into evidence. When a lawyer asks a question or offers an exhibit into evidence and a lawyer on the other side thinks that it is not permitted by the rules of evidence, that lawyer may object. If I overrule the objection, the question may be answered or the exhibit received. If I sustain the objection, the question cannot be answered, and the exhibit cannot be received. Whenever I sustain an objection to a question, you must ignore the question and must not guess what the answer might have been.

Sometimes I may order that evidence be stricken from the record and that you disregard or ignore the evidence. That means that when you are deciding the case, you must not consider the evidence that I told you to disregard.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.10.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [8] – CREDIBILITY OF WITNESSES

In deciding the facts in this case, you may have to decide which testimony to believe and which testimony not to believe. You may believe everything a witness says, or part of it, or none of it. Proof of a fact does not necessarily depend on the number of witnesses who testify about it.

In considering the testimony of any witness, you may take into account:

- (1) the opportunity and ability of the witness to see or hear or know the things testified to;
- (2) the witness’s memory;
- (3) the witness’s manner while testifying;
- (4) the witness’s interest in the outcome of the case and any bias or prejudice;
- (5) whether other evidence contradicted the witness’s testimony;
- (6) the reasonableness of the witness’s testimony in light of all the evidence; and
- (7) any other factors that bear on believability.

The weight of the evidence as to a fact does not necessarily depend on the number of witnesses who testify about it.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.11.

Court Comments: No objection by the parties.

JURY INSTRUCTION NO. [9] – CONDUCT OF THE JURY

I will now say a few words about your conduct as jurors.

First, keep an open mind throughout the trial, and do not decide what the verdict should be until you and your fellow jurors have completed your deliberations at the end of the case.

Second, because you must decide this case based only on the evidence received in the case and on my instructions as to the law that applies, you must not be exposed to any other information about the case or to the issues it involves during the course of your jury duty. Thus, until the end of the case or unless I tell you otherwise:

Do not communicate with anyone in any way and do not let anyone else communicate with you in any way about the merits of the case or anything to do with it. This includes discussing the case in person, in writing, by phone or electronic means, via e-mail, text messaging, or any Internet chat room, blog, Web site or other feature. This applies to communicating with your fellow jurors until I give you the case for deliberation, and it applies to communicating with everyone else including your family members, your employer, and the people involved in the trial, although you may notify your family and your employer that you have been seated as a juror in the case. But, if you are asked or approached in any way about your jury service or anything about this case, you must respond that you have been ordered not to discuss the matter and to report the contact to the court.

Because you will receive all the evidence and legal instruction you properly may consider to return a verdict: do not read, watch, or listen to any news or media accounts or commentary about the case or anything to do with it; do not do any research, such as consulting dictionaries, searching the Internet or using other reference materials; and do not make any investigation or in any other way try to learn about the case on your own.

The law requires these restrictions to ensure the parties have a fair trial based on the same evidence that each party has had an opportunity to address. A juror who violates these restrictions

1 jeopardizes the fairness of these proceedings[, and a mistrial could result that would require the
2 entire trial process to start over]. If any juror is exposed to any outside information, please notify
3 the court immediately.

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5 Authority: 9th Cir. Model Jury Instruction No. 1.12.

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7 Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [10] – NO TRANSCRIPT AVAILABLE TO JURY

During deliberations, you will have to make your decision based on what you recall of the evidence. You will not have a transcript of the trial. I urge you to pay close attention to the testimony as it is given.

If at any time you cannot hear or see the testimony, evidence, questions or arguments, let me know so that I can correct the problem.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.13.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [11] – TAKING NOTES

If you wish, you may take notes to help you remember the evidence. If you do take notes, please keep them to yourself until you and your fellow jurors go to the jury room to decide the case. Do not let note-taking distract you. When you leave, your notes should be left in the envelope in the jury room. No one will read your notes. They will be destroyed at the conclusion of the case.

Whether or not you take notes, you should rely on your own memory of the evidence. Notes are only to assist your memory. You should not be overly influenced by your notes or those of your fellow jurors.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.14.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [15] – BENCH CONFERENCES AND RECESSES

From time to time during the trial, it may become necessary for me to talk with the attorneys out of the hearing of the jury, either by having a conference at the bench when the jury is present in the courtroom, or by calling a recess. Please understand that while you are waiting, we are working. The purpose of these conferences is not to keep relevant information from you, but to decide how certain evidence is to be treated under the rules of evidence and to avoid confusion and error.

Of course, we will do what we can to keep the number and length of these conferences to a minimum. I may not always grant an attorney’s request for a conference. Do not consider my granting or denying a request for a conference as any indication of my opinion of the case or of what your verdict should be.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.18.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [12] – OUTLINE OF TRIAL

Trials proceed in the following way: First, each side may make an opening statement. An opening statement is not evidence. It is simply an outline to help you understand what that party expects the evidence will show. A party is not required to make an opening statement.

The plaintiff will then present evidence, and counsel for the defendant may cross-examine. Then the defendants may present evidence, and counsel for the plaintiff may cross-examine.

After the evidence has been presented, I will instruct you on the law that applies to the case and the attorneys will make closing arguments.

After that, you will go to the jury room to deliberate on your verdict.

Authority: 9th Cir. Model Civil Jury Instruction No. 1.19.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [27] – STIPULATIONS OF FACT

The parties have agreed to certain facts that will be read to you. You should therefore treat these facts as having been proved.

Authority: 9th Cir. Model Civil Jury Instruction No. 2.2.

Court Comments: No objection by the parties. The Court asks the parties whether they agree to include as part of this instruction the facts that the parties stipulated to in their Joint Proposed Pretrial Order (located at Docket No. 161).

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JURY INSTRUCTION NO. [16] – DEPOSITION IN LIEU OF LIVE TESTIMONY

A deposition is the sworn testimony of a witness taken before trial. The witness is placed under oath to tell the truth and lawyers for each party may ask questions. The questions and answers are recorded. [When a person is unavailable to testify at trial, the deposition of that person may be used at the trial.]

The deposition of [witness] was taken on [date]. You should consider deposition testimony, presented to you in court in lieu of live testimony, insofar as possible, in the same way as if the witness had been present to testify.

[Do not place any significance on the behavior or tone of voice of any person reading the questions or answers.]

Authority: 9th Cir. Model Civil Jury Instruction No. 2.4.

Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. [17] – USE OF INTERROGATORIES OF A PARTY

Evidence [will now be] [was] presented to you in the form of answers of one of the parties to written interrogatories submitted by the other side. These answers [have been] [were] given in writing and under oath, before the actual trial, in response to questions that were submitted in writing under established court procedures. You should consider the answers, insofar as possible, in the same way as if they were made from the witness stand.

Authority: 9th Cir. Model Civil Jury Instruction No. 2.10.

Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. [24] – EXPERT OPINION

Some witnesses, because of education or experience, are permitted to state opinions and the reasons for those opinions.

Opinion testimony should be judged just like any other testimony. You may accept it or reject it, and give it as much weight as you think it deserves, considering the witness’s education and experience, the reasons given for the opinion, and all the other evidence in the case.

Authority: 9th Cir. Model Civil Jury Instruction No. 2.11.

Court Comments: No objection by the parties.

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JURY INSTRUCTION NO. [28] – CHARTS AND SUMMARIES

NOT RECEIVED IN EVIDENCE

Certain charts and summaries not received in evidence [may be] [have been] shown to you in order to help explain the contents of books, records, documents, or other evidence in the case. They are not themselves evidence or proof of any facts. If they do not correctly reflect the facts or figures shown by the evidence in the case, you should disregard these charts and summaries and determine the facts from the underlying evidence.

Authority: 9th Cir. Model Civil Jury Instruction No. 2.12.

Court Comments: The parties stipulated to this instruction.

1 **JURY INSTRUCTION NO. [29] – CHARTS AND SUMMARIES RECEIVED IN EVIDENCE**

2 Certain charts and summaries [may be] [have been] received into evidence to illustrate
3 information brought out in the trial. Charts and summaries are only as good as the underlying
4 evidence that supports them. You should, therefore, give them only such weight as you think the
5 underlying evidence deserves.

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7 Authority: 9th Cir. Model Civil Jury Instruction No. 2.13.

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9 Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. [30] – DUTY TO DELIBERATE

When you begin your deliberations, you should elect one member of the jury as your presiding juror. That person will preside over the deliberations and speak for you here in court.

You will then discuss the case with your fellow jurors to reach agreement if you can do so. Your verdict must be unanimous.

Each of you must decide the case for yourself, but you should do so only after you have considered all of the evidence, discussed it fully with the other jurors, and listened to the views of your fellow jurors.

Do not hesitate to change your opinion if the discussion persuades you that you should. Do not come to a decision simply because other jurors think it is right.

It is important that you attempt to reach a unanimous verdict but, of course, only if each of you can do so after having made your own conscientious decision. Do not change an honest belief about the weight and effect of the evidence simply to reach a verdict.

Authority: 9th Cir. Model Civil Jury Instruction No. 3.1.

Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. [31] – COMMUNICATION WITH COURT

If it becomes necessary during your deliberations to communicate with me, you may send a note through the clerk, signed by your presiding juror or by one or more members of the jury. No member of the jury should ever attempt to communicate with me except by a signed writing; I will communicate with any member of the jury on anything concerning the case only in writing, or here in open court. If you send out a question, I will consult with the parties before answering it, which may take some time. You may continue your deliberations while waiting for the answer to any question. Remember that you are not to tell anyone – including me – how the jury stands, numerically or otherwise, until after you have reached a unanimous verdict or have been discharged. Do not disclose any vote count in any note to the court.

Authority: 9th Cir. Model Civil Jury Instruction No. 3.2.

Court Comments: The parties stipulated to this instruction.

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JURY INSTRUCTION NO. ____ – RETURN OF VERDICT

A verdict form has been prepared for you. After you have reached unanimous agreement on a verdict, your presiding juror will fill in the form that has been given to you, sign and date it, and advise the court that you are ready to return to the courtroom.

Authority: 9th Cir. Model Civil Jury Instruction No. 3.3.

Court Comments: The Court commonly gives this instruction.

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JURY INSTRUCTION NO. ____ – CLAIMS ASSERTED BY THE PLAINTIFF

The SEC claims that the defendant has violated various provisions of federal securities law, in particular the Exchange Act and the Securities Act. The specific claims asserted by the SEC are as follows:

- (1) Violation of Rule 10b-5 of the Exchange Act.
- (2) Aiding and abetting violation of Rule 10b-5.
- (3) Violation of Section 17(a)(1) of the Securities Act.
- (4) Violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act.
- (5) Aiding and abetting violation of Section 14(a) and Rule 14a-9 of the Exchange Act.
- (6) Aiding and abetting violation of Section 13(a) of the Exchange Act.
- (7) Violation of Section 13(b)(5) of the Exchange Act.
- (8) Violation of Rule 13b2-1 of the Exchange Act.
- (9) Aiding and abetting violation of Section 13(b)(2)(A) of the Exchange Act.
- (10) Aiding and abetting violation of Section 13(b)(2)(B) of the Exchange Act.

Authority: See Joint Proposed Pretrial Order at 6-12.

Court Comments: This instruction would provide a helpful roadmap for the jury.

JURY INSTRUCTION NO. [32P] – SECURITIES FRAUD – STATUTORY PURPOSE

1 The Securities Act and the Exchange Act were enacted to protect the investing public in the
2 purchase of securities that are publicly distributed. These two Acts provide a comprehensive plan
3 requiring full and fair disclosure of all important facts in connection with a distribution of securities.
4 Such disclosures are designed to enable the investing public to make realistic appraisals of the
5 merits of securities so that investors may make informed investment decisions. When it enacted the
6 Securities Act and the Exchange Act, Congress recognized that the purchase of securities is different
7 from the purchase of a vegetable bought in the grocery store in that the average investor is not in a
8 position to make a personal investigation to determine the worth, quality and value of securities.
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10 The anti-fraud provisions of the Securities Act and the Exchange Act are designed to control
11 and remedy schemes to defraud. Those anti-fraud provisions were designed to protect investors by
12 requiring full and truthful disclosure of all important facts regarding the character of a security and
13 to prevent investors from being victimized by fraud.
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16 Court Comments: This instruction has been offered by the SEC only. The Court is not inclined to
17 give the proffered instruction. Going into this level of detail about the purpose of the federal
18 securities laws is unnecessary. Ultimately, the purpose of the laws is irrelevant. What matters is
19 whether the SEC has proven the elements of the alleged statutory violations.
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**JURY INSTRUCTION NO. [33P & 33D] – SECURITIES –
DEFINITION OF RECURRING TERMS**

Congress has enacted securities laws designed to protect the integrity of financial markets.

There are terms concerning securities laws that have a specific legal meaning. The following definitions apply throughout these instructions, unless noted otherwise.

A security is an investment of money in a commercial, financial or other business enterprise, with the expectation of profit or other gain produced by the efforts of others. Some common types of securities are stocks and options to purchase stock.

The buying and selling of securities is controlled by the Securities Laws. Many of these laws are administered by the SEC.

An instrumentality of interstate commerce includes the postal mails, e-mails, telephone, telegraph, telefax, interstate highway system, Internet and similar methods of communication and travel from one state to another within the United States.

Authority: 9th Cir. Model Civil Jury Instruction No. 18.0 (modified).

Court Comments: Each party has submitted a proposed version. The Court has excluded the paragraphs on (1) Rule 10b-5, (2) materiality, and (3) “in connection with” because these paragraphs are not applicable to *each* of the securities claims being asserted by the SEC. For example, the 10b-5 claim is only one out of the ten claims asserted by the SEC. Also, for some of the claims asserted by the SEC, there is no materiality requirement.

1 **JURY INSTRUCTION NO. [55D] – SECURITIES – BACKDATING OF STOCK OPTIONS**

2 “Backdating” – insofar as that term means pricing stock options on a day prior to the date of
3 the grant – is not in and of itself a violation of the federal securities law. However, evidence of such
4 practices may be considered by you, along with other evidence, in connection with the claims
5 asserted against the defendant. In other words, you may consider evidence of retroactive pricing, or
6 “backdating,” in light of the specific elements that must be proved in connection with each of the
7 claims asserted.

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9 Court Comments: An instruction on backdating has been offered by the defendant only. An
10 instruction on backdating is helpful. However, the instruction proposed by the defendant can be
11 simplified. The proposed instruction is basically a modification of the instruction on backdating that
12 Judge Breyer has given in a criminal case. *See United States v. Jensen*, No. CR-06-0556 CRB
13 (Docket No. 716) (Jury Instructions at 22).

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1 **JURY INSTRUCTION NO. [56D] – SECURITIES – ACCOUNTING GUIDELINES**

2 You have heard reference at times during the trial to generally accepted accounting
3 principles ('GAAP'), Accounting Principles Board Opinion No. 25 ('APB 25'), Financial
4 Accounting Standard 123 ('FAS 123') and Financial Accounting Standards Board Interpretation No.
5 44 ('FIN 44'). Except where otherwise provided, a violation of these principles, opinion, standards,
6 or guidelines in and of itself, does not establish a violation of the securities law. However, evidence
7 of such accounting violations may be considered by you, along with other evidence, in connection
8 with the violations alleged.

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11 Court Comments: This instruction offered by the defendant is problematic.

12 First, as the SEC points out, some of the claims asserted against the defendant are measured
13 by accounting guidelines. For example, Section 13(b)(2)(B)(ii) provides: "Every issuer . . . shall – .
14 . . (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable
15 assurances that – . . . (ii) transactions are recorded as necessary (I) to permit preparation of financial
16 statements in conformity with generally accepted accounting principles or any other criteria
17 applicable to such statements, and (II) to maintain accountability for assets." 15 U.S.C. §
18 78m(b)(2)(B)(ii).

19 Second, the authority cited by the defendant in its memo, *see* Def.'s Memo. at 25, simply
20 state that a failure to follow accounting guidelines does not establish scienter. But not all of the
21 claims asserted by the SEC involve scienter – indeed, some require negligence only.

22 However, the proposed instruction is based on that given by Judge Breyer in *United States v.*
23 *Reyes*, CR-06-0556 CRB (Docket No. 1158) (Jury Instructions at 38). As modified herein, it is
24 appropriate.

VIOLATION OF RULE 10b-5

JURY INSTRUCTION NO. [34] – RULE 10b-5 CLAIM – ESSENTIAL ELEMENTS

A “10b-5 claim” is a claim brought under a federal statute, Section 10(b) of the Exchange Act, which in essence prohibits acts of deception in connection with the purchase or sale of a security and in violation of rules and regulations that the SEC has the duty and power to issue. A corresponding SEC Rule, Rule 10b-5, prohibits the misrepresentation of material facts and the omission of material facts in connection with the purchase or sale of securities. A person or business entity who violates the securities laws, including Rule 10b-5, may be liable for the violation.

The SEC alleges that the defendant violated Rule 10b-5 by participating in a scheme to defraud shareholders of Embarcadero and making, or helping others make, material misrepresentations and omissions of fact regarding how Embarcadero granted and accounted for employee stock options.

On this claim, the SEC has the burden of proving each of the following elements by a preponderance of the evidence:

1. The defendant did any of the following things in connection with the purchase or sale of securities: (a) employed a device, scheme or artifice to defraud; or (b) made an untrue statement of a material fact; or omitted a material fact necessary under the circumstances to keep the statements that were made from being misleading; or (c) engaged in an act, practice or course of business that operated as a fraud or deceit;
2. The defendant acted knowingly; and
3. The defendant used or caused the use of an instrumentality of interstate commerce, such as mail or telephone facility of a national securities exchange in connection with the purchase or sale of securities, regardless whether the instrumentality or facility itself was used to make an untrue statement or a material omission.

If you find that the SEC has proved all of the above elements, your verdict should be for the SEC. If, on the other hand, you find that the SEC has failed to prove one or more of these

1 elements, your verdict should be for the defendant.

2

3 Authority: 9th Cir. Model Civil Jury Instruction No. 18.0 (modified); 9th Cir. Model Civil Jury
4 Instruction No. 18.1 (modified).

5

6 Court Comments: The parties stipulated to a modified version of 9th Cir. Model Civil Jury
7 Instruction No. 18.1. The Court has made some changes to the parties' proposed instruction. For
8 example, the Court has included part of 9th Cir. Model Civil Jury Instruction No. 18.0 as part of this
9 instruction – *i.e.*, the paragraph that talks about Rule 10b-5.

10 Also, the Court has omitted the phrase “or recklessly.” This is because the term “knowingly”
11 is defined in the next instruction to include reckless conduct. The SEC is free to argue to the jury
12 that the definition of “knowingly” includes recklessly.

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**JURY INSTRUCTION NO. [36P, 36D & 37D] – RULE 10b-5 CLAIM –
MISREPRESENTATIONS OR OMISSIONS – MATERIALITY**

The SEC must prove by a preponderance of the evidence that the misrepresentation or omission of the defendant was material.

A factual representation concerning a security is material if there is a substantial likelihood a reasonable investor would consider the fact important in deciding whether or not to buy or sell that security.

An omission concerning a security is material if a reasonable investor would have regarded what was not disclosed to [him] [her] as having significantly altered the total mix of information [he] [she] took into account in deciding whether to buy or sell the security.

You must decide whether something was material based on the circumstances as they existed at the time of the statement or omission.

Authority: 9th Cir. Model Civil Jury Instruction No. 18.2.

Court Comments: The SEC has offered the Ninth Circuit model instruction. The defendant has offered a modified version of the model instruction (see Disputed Instruction No. 36D), plus another instruction on materiality (see Disputed Instruction No. 37D). The defendant’s proposed instructions are significantly divergent from the Ninth Circuit model. Moreover, the defendant’s instruction on “duty to disclose” (*i.e.*, Disputed Instruction No. 18B) is potentially confusing. The Court intends to adhere closely to the Ninth Circuit model instruction.

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JURY INSTRUCTION NO. [35] – RULE 10b-5 CLAIM – KNOWINGLY

A defendant acts knowingly when he makes an untrue statement with the knowledge that the statement was false or with reckless disregard for whether the statement was true. A defendant acts knowingly if he omits necessary information with the knowledge that the omission would make the statement false or misleading or with reckless disregard for whether the omission would make the statement false or misleading.

“Reckless” means highly unreasonable conduct that is an extreme departure from ordinary care, presenting a danger of misleading investors, which is either known to the defendant or is so obvious that the defendant must have been aware of it.

Authority: 9th Cir. Model Civil Jury Instruction No. 18.3.

Court Comments: The parties stipulated to this instruction.

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AIDING AND ABETTING VIOLATION OF RULE 10b-5

**JURY INSTRUCTION NO. [39] – AIDING AND ABETTING VIOLATION OF RULE 10b-5
– ESSENTIAL ELEMENTS**

The SEC also claims that the defendant aided and abetted another person’s violations of Rule 10b-5. To prove this aiding and abetting claim, the SEC must establish by a preponderance of the evidence that:

1. Another person (*i.e.*, someone other than the defendant) violated Rule 10b-5 by knowingly participating in a scheme to defraud or making material misrepresentations or omissions of fact (known as the “primary violation”); and
2. the defendant had actual knowledge of both the primary violation and of his role in furthering it; and
3. the defendant provided substantial assistance in the primary violation.

The SEC must establish all of the elements listed in Instruction No. ____ for each claimed primary violation.

Authority: *SEC v. Fehn*, 97 F.3d 1276, 1288 (9th Cir. 1996) (stating that elements of claim for aiding and abetting violation under Section 10(b) are as follows: “(1) the existence of an independent primary violation; (2) actual knowledge by the alleged aider and abettor of the primary violation and of his or her own role in furthering it; and (3) ‘substantial assistance’ by the defendant in the commission of the primary violation”).

Court Comments: The parties provided a stipulated instruction, which the Court has modified for purposes of clarity.

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**JURY INSTRUCTION NO. [40D] – AIDING AND ABETTING VIOLATION OF
RULE 10b-5 – ANOTHER PERSON**

As stated in Instruction No. _____, to prove that the defendant aided and abetted any securities violation, the SEC must prove that “another person” committed a securities violation. Thus, unless you find that some person other than the defendant caused Embarcadero’s financial records or disclosures to be inaccurate, you cannot find that the defendant was guilty of aiding and abetting.

Authority: *SEC v. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009) (noting that, for claim of aiding and abetting a securities violation, one element is “the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party”).

Court Comments: An instruction on “another person” has been offered by the defendant only. The Court proposes a modified version of the instruction.

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**JURY INSTRUCTION NO. [41D] – AIDING AND ABETTING VIOLATION OF
RULE 10b-5 – ACTUAL KNOWLEDGE**

~~For any aiding and abetting claim, it is not enough for the SEC to prove that the defendant was careless, negligent, or even reckless in his knowledge of the primary violation and any assistance in furthering it. Instead, the SEC must prove that the defendant had actual knowledge of both the primary violation committed by someone else and his role in substantially furthering it.~~

Authority: *SEC v. Hilsenrath*, No. C 03-03252 WHA, 2008 U.S. Dist. LEXIS 50021, at *25 (N.D. Cal. May 30, 2008) (stating that the Ninth Circuit “requires that there be actual knowledge by the alleged aider and abettor of the primary violation and of his own role in furthering it, and that he substantially assist in the commission of the primary violation”).

Court Comments: This instruction has been offered by the defendant only. This instruction is unnecessary given the general instruction on aiding and abetting a Rule 10b-5 violation above which addresses knowledge.

1 **JURY INSTRUCTION NO. [42D] – AIDING AND ABETTING VIOLATION OF**
2 **RULE 10b-5 – SUBSTANTIAL ASSISTANCE**

3 As stated in Instruction No. _____, to prove that the defendant aided and abetted any
4 securities violation, the SEC must prove that the defendant “substantially assisted” someone else in
5 committing a securities violation.

6 “Substantially assisted” means that the defendant’s assistance was a substantial factor in
7 causing the securities violation.

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9 Authority: *K & S P’ship v. Continental Bank, N.A.*, 952 F.2d 971, 979 (8th Cir. 1991) (in case
10 involving claim for aiding and abetting a securities violation, stating that, to establish substantial
11 assistance, the plaintiff must “show that the secondary party proximately caused the violation, or, in
12 other words, that the encouragement or assistance was a substantial factor in causing the tort”).

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14 Court Comments: An instruction on “substantial assistance” has been offered by the defendant only.
15 The Court agrees that the phrase “substantial assistance” is somewhat of a term of art such that a
16 definition for the jury would be helpful. That being said, the definition offered by the defendant has
17 problems – in particular, its use of another term of art (*i.e.*, proximate cause) and its suggestion that
18 substantial assistance means but-for causation.

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VIOLATION OF SECTION 17(a)(1)

**JURY INSTRUCTION NO. [43P, 43D & 44P] – SECTION 17(a)(1) CLAIM –
ESSENTIAL ELEMENTS**

The SEC alleges that the defendant’s conduct constituted not only a violation of Rule 10b-5 but also a violation of Section 17(a)(1) of the Securities Act.

The Section 17(a)(1) claim is nearly identical to the Rule 10b-5 claim. On the Section 17(a)(1) claim, the SEC has the burden of proving each of the following elements by a preponderance of the evidence:

1. The defendant knowingly made material misrepresentations or materially misleading omissions;
2. in the offer or sale of securities;
3. by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails.

The terms “knowingly” and “material” or “materially” are defined in Instructions Nos. ____ and ____ above.

Authority: 15 U.S.C. § 77q(a)(1) (providing that “[i]t shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly – (1) to employ any device, scheme, or artifice to defraud”); *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 766 (11th Cir. 2007) (stating that, “[t]o show a violation of section 17(a)(1), the SEC must prove (1) material misrepresentations or materially misleading omissions, (2) in the offer or sale of securities, (3) made with scienter”).

Court Comments: Each party has submitted a proposed instruction. There are problems with both the SEC’s proposed instruction and the defendant’s. For example, the SEC’s proposed instruction is

1 a little confusing and overly simplistic. The defendant's proposed instruction is confusing because,
2 although it tracks the language of Section 17(a), it does not separate out Section 17(a)(1) from
3 Sections 17(a)(2) and 17(a)(3). Such a separation is necessary because, as discussed below, Section
4 17(a)(1) requires scienter whereas negligence is sufficient under Sections 17(a)(2) and 17(a)(3).

5 The proposed instruction acknowledges the similarities with the Rule 10b-5 claim (as the
6 SEC desires) but it also spells out specific elements that need to be met (as the defendant desires).

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VIOLATION OF SECTION 17(a)(2) AND 17(a)(3)

**JURY INSTRUCTION NO. [44P] – SECTION 17(a)(2) AND 17(a)(3) CLAIMS –
ESSENTIAL ELEMENTS**

The SEC further claims that the defendant violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

For the Section 17(a)(2) and 17(a)(3) claims, the SEC has the burden of proving by a preponderance of the evidence each of the following elements:

1. The defendant negligently made material misrepresentations or materially misleading omissions;
2. in the offer or sale of securities;
3. by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails.

The Section 17(a)(2) and 17(a)(3) claims differ from the Section 17(a)(1) claim only with respect to the level of knowledge required. That is, while the Section 17(a)(1) claim requires that the defendant act knowingly, the Section 17(a)(2) and 17(a)(3) claims require that the defendant act with negligence only.

Authority: 15 U.S.C. § 77q(a)(2)-(3) (providing that “[i]t shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser”); *SEC v. Curshen*, No. 09-1196, 2010 U.S. App. LEXIS 7555, at *12 (10th Cir. Apr. 13, 2010) (stating that “[t]he primary difference between § 17(a) and § 10(b) lies in the element of

1 scienter” – *i.e.*, “Section 10(b) and § 17(a)(1) require the SEC to establish scienter, whereas
2 negligence is sufficient for § 17(a)(2) and § 17(a)(3)”); *SEC v. Seghers*, No. 06-11146, 2008 U.S.
3 App. LEXIS 23507, at *18 (5th Cir. Oct. 28, 2008) (stating that, “[t]o show that a defendant has
4 violated § 17(a)(2) or § 17(a)(3), the Commission need only show that the defendant acted with
5 negligence”); *SEC v. Ficken*, 546 F.3d 45, 47 (1st Cir. 2008) (stating that “[p]roof of scienter is
6 required to establish violations of § 17(a)(1), § 10(b), or Rule 10b-5, while negligence is sufficient
7 to establish liability under § 17(a)(2) or § 17(a)(3)”); *SEC v. Phan*, 500 F.3d 895, 909 (9th Cir.
8 2007) (stating that “[v]iolations of Section 17(a)(1), Section 10(b) and Rule 10b-5 require *scienter*
9 [while] [v]iolations of Sections 17(a)(2) and (3) require a showing of negligence”); *SEC v.*
10 *Merchant Capital, LLC*, 483 F.3d 747, 766 (11th Cir. 2007) (noting that, “to show that the
11 defendants violated section 17(a)(2) or 17(a)(3), the SEC need only show (1) material
12 misrepresentations or materially misleading omissions, (2) in the offer or sale of securities, (3) made
13 with negligence”); *Weiss v. SEC*, 468 F.3d 849, 855 (D.C. Cir. 2006) (noting that “[p]roof of
14 negligence is sufficient to establish a violation of” Sections 17(a)(2) and 17(a)(3)).

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16 Court Comments: The SEC has offered a proposed instruction. The defendant does not offer any
17 proposed instruction, arguing instead that these claims have never been at issue in this case. The
18 defendant’s position is rejected. As the SEC argues, the complaint tracks the language of Sections
19 17(a)(2) and 17(a)(3). *Compare* 15 U.S.C. § 77q(a)(2)-(3), *with* Compl. ¶ 96. Moreover, contrary to
20 what the defendant argues, the SEC is not trying to make a claim for “negligent fraud” under Section
21 17(a)(3). Section 17(a)(3) refers to conduct that “*operates* or would *operate* as a fraud or deceit
22 upon the purchaser.” 15 U.S.C. § 77q(a)(3) (emphasis added). Section 17(a)(3) in other words is
23 simply about a negligent misrepresentation or omission.

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1 **AIDING AND ABETTING VIOLATION OF SECTION 14(a) AND RULE 14a-9**

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3 **JURY INSTRUCTION NO. [46P & 46D] – AIDING AND ABETTING VIOLATION OF**
4 **SECTION 14(a) AND RULE 14a-9 – ESSENTIAL ELEMENTS**

5 The SEC alleges that the defendant aided and abetted Embarcadero’s violations of Section
6 14(a) and Rule 14a-9 of the Exchange Act.

7 To prove this claim, the SEC must establish by a preponderance of the evidence that:

- 8 1. Embarcadero acted at least negligently (as defined in Instruction No. ____ above) in
9 disseminating one or more proxy statements to its shareholders that were false or misleading
10 with respect to any material fact (known as the “primary violation”);
11 2. the defendant had actual knowledge of both the primary violation and of his role in
12 furthering it; and
13 3. the defendant provided substantial assistance in the primary violation.

14 The term “material” is defined in Instruction No. ____ above.

15 There is no requirement that Embarcadero knowingly (as defined in Instruction No. ____
16 above) disseminated false or misleading information. However, the SEC must still prove that the
17 defendant had actual knowledge of the primary violation and his role in furthering it.

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19 Authority: 15 U.S.C. § 78n(a); 17 C.F.R. § 240.14a-9(a) (providing that “[n]o solicitation subject to
20 this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or
21 other communication, written or oral, containing any statement which, at the time and in the light of
22 the circumstances under which it is made, is false or misleading with respect to any material fact, or
23 which omits to state any material fact necessary in order to make the statements therein not false or
24 misleading or necessary to correct any statement in any earlier communication with respect to the
25 solicitation of a proxy for the same meeting or subject matter which has become false or
26 misleading”); *California Pub. Empl’s. Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 168 (3d Cir. 2004)
27 (stating that “Section 14(a) liability attaches to all parties who negligently execute a proxy
28 statement”); *Kennedy v. Venrock Assocs.*, 348 F.3d 584, 593 (7th Cir. 2003) (stating that

1 “[n]egligent omission of material information from a proxy statement violates . . . federal securities
2 law, see Section 14(a) of the Securities Exchange Act of 1934”); *In re McKesson HBOC, Inc. Sec.*
3 *Litig.*, 126 F. Supp. 2d 1248, 1264 (N.D. Cal. 2000) (“hold[ing] that all persons liable under Section
4 14 should be held to the same standard of culpability: negligence”).

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6 Court Comments: The parties have offered competing versions of the instruction. The Court agrees
7 with the SEC that there should be a clarification that Embarcadero need not have acted knowingly.
8 The Court also agrees with the defendant that this statement should be accompanied by a reminder
9 that the defendant(as opposed to Embarcadero) must still have acted with actual knowledge.

10 As to whether there should be, as advocated by the defendant, a statement that
11 Embarcadero’s primary violation must have been accomplished by a person acting on
12 Embarcadero’s behalf other than the defendant, the Court is not persuaded. It finds guidance in *SEC*
13 *v. Koenig*, No. 02 C 2180, 2007 U.S. Dist. LEXIS 26088 (N.D. Ill. Apr. 5, 2007). There, the
14 defendant argued that “he cannot be found liable both for violating securities laws as the CFO of
15 Waste Management and for aiding and abetting Waste Management in violating securities laws.” *Id.*
16 at *17.

17 Koenig argues that under *U.S. v. Doig*, 950 F.2d 411 (7th Cir.
18 1991), an OSHA case, it is “logically inconsistent” to find an agent’s
19 actions both as proof of a company’s primary violations and as proof
of the agent’s aiding and abetting violations. For the following
reasons, [this] argument . . . fails.

20 In *Doig*, when a company was charged with a primary
21 violation under OSHA for the death of an employee, and a manager
22 was charged with aiding and abetting the primary violation, the
Seventh Circuit held that the statutory framework of OSHA did not
23 permit an employee to be held responsible as an aider and abettor of
an employer’s violation. The court was clear that, had the employee
24 been a director of the company, he could also have been an employer;
then the aiding and abetting charge would have been proper. *Doig*,
950 F.2d at 415, n.5. The court further found employee liability to be
25 inconsistent with the statutory scheme of OSHA.

26 Koenig’s reliance on *Doig*, however, is not persuasive because,
27 although OSHA was silent on employee liability for aiding and
abetting a primary violation, Congress was clear that aiders and
28 abettors may be held liable for violations of the federal securities laws.
See SEC v. Buntrock, 2004 U.S. Dist. LEXIS 9495 (N.D. Ill. May 25,
2004).

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More fundamentally, the crux of Koenig’s argument is that of “double-counting.” He claims that, because a corporation cannot act on its own but only through a natural person, and he was the sole defendant on trial, he cannot be responsible for both the primary violation and the aiding and abetting violation. Koenig is incorrect both factually and legally.

The record at trial is replete with evidence of misconduct involving Waste Management employees other than Koenig. Others were involved with Koenig in many of the issues in this case, including capitalized interest, depreciation adjustments, geography entries, bundling and basketing, and financial and disclosure matters. Additionally, the evidence demonstrated that Koenig was not alone in his awareness that the accounting was out of step with GAAP. On this level alone, Koenig’s arguments against the verdicts of aiding and abetting fail. Koenig’s legal arguments also fail. One may aid and abet a corporate entity even if, unlike here, there was evidence of misconduct by only one agent. *See U.S. v. Sain*, 141 F.3d 463 (3d Cir. 1998); *SEC v. Cohen*, No. 4:05 CV 371, 2006 U.S. Dist. LEXIS 53498 (E.D. Mo. Aug. 2, 2006). While a corporation as an independent legal entity exists outside of the actions of its directors, it can act only through the actions of natural persons. To hold that Koenig cannot have acted to aid and abet Waste Management’s violations as well as being primary liable for Waste Management’s violations is contrary to the intent of the securities laws and to our reasoning.

Id. at *17-20; *see also Sain*, 141 F.3d at 474 (in a criminal case involving fraud, rejecting the defendant’s argument that could not have aided and abetted the company’s wrongdoing because he owned and completely controlled the company; stating that the company, “because it is a corporation, is a separate legal entity, even though [defendant] owned all the stock,” and therefore the company had “the capacity of being aided and abetted” – “[t]o hold otherwise would allow the controlling stockholder of a corporation to enjoy the benefits of the corporate form, protection from personal liability for corporation’s debts, without accepting the burden of assuming criminal responsibility when the individual causes the corporation to commit a crime”); *Cohen*, 2006 U.S. Dist. LEXIS 53498, at *12-13 (rejecting defendant’s argument that “he could not have aided and abetted a primary party . . . because TALX, as a corporation, cannot act on its own and therefore defendant himself is alleged to be the primary party”).

AIDING AND ABETTING VIOLATION OF SECTION 13(a)

JURY INSTRUCTION NO. [47P & 47D] – AIDING AND ABETTING VIOLATION OF SECTION 13(a) – ESSENTIAL ELEMENTS

The SEC claims that the defendant also aided and abetted Embarcadero’s violations of Section 13(a) of the Exchange Act. Section 13(a) and its rules require public companies, such as Embarcadero, to file periodic reports to shareholders quarterly and annually that describe their financial condition, and to timely file current reports as needed. In particular, public companies are required to file annual reports on Forms 10-K, quarterly reports on Forms 10-Q, and current reports on Forms 8-K. The reports must not be materially inaccurate or misleading.

To prove this aiding and abetting claim, the SEC must establish by a preponderance of the evidence that:

1. Embarcadero filed a materially inaccurate or misleading Form 10-K, or Form 10-Q, or Form 8-K (known as the “primary violation”);
2. the defendant had actual knowledge of both the primary violation and of his role in furthering it; and
3. the defendant provided substantial assistance in the primary violation.

The term “material” is defined in Instruction No. ____ above.

There is no requirement that Embarcadero knowingly (as defined in Instruction No. ____ above) filed a materially inaccurate or misleading report. However, the SEC must still prove that the defendant had actual knowledge of the primary violation and his role in furthering it.

Authority: 15 U.S.C. § 78m(a) (providing that “[e]very issuer of a security registered pursuant to section 12 of this title [15 U.S.C. § 78l] shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security – (1) such information and documents (and such copies thereof) as the Commission shall require to keep reasonably current the information and documents required to be included in or filed with an application or registration

1 statement filed pursuant to section 12 [15 U.S.C. § 78I], . . . (2) such annual reports (and such copies
2 thereof), certified if required by the rules and regulations of the Commission by independent public
3 accountants, and such quarterly reports (and such copies thereof), as the Commission may
4 prescribe”); 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, 240.13a-13; 15 U.S.C. § 78t(e)
5 (providing that, “[f]or purposes of any action brought by the Commission under paragraph (1) or (3)
6 of section 21(d) [15 U.S.C. § 78u(d)(1) or (3)], any person that knowingly provides substantial
7 assistance to another person in violation of a provision of this title [15 U.S.C. §§ 78a et seq.], or of
8 any rule or regulation issued under this title [15 U.S.C. §§ 78a et seq.], shall be deemed to be in
9 violation of such provision to the same extent as the person to whom such assistance is provided”);
10 *Ponce v. SEC*, 345 F.3d 722, 737 (9th Cir. 2003) (stating that, “[i]n order to find that Ponce aided
11 and abetted [the company’s] violation of federal securities laws, it must be found that: (1) [the
12 company] violated the relevant securities laws; (2) Ponce had knowledge of the primary violation
13 and of his or her own role in furthering it; and (3) Ponce provided substantial assistance in the
14 primary violation”); *SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998) (stating that “scienter is not
15 an element of civil claims under” Section 13(a)); *SEC v. Todd*, No. 03CV2230 BEN (WMc), 2007
16 U.S. Dist. LEXIS 38985, at *42 (S.D. Cal. May 30, 2007) (stating that “[s]cienter is not required to
17 find aiding and abetting liability under § 13(a) and Rules 12b-20 and 13a-13”).

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19 Court Comments: See prior instruction.

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1 VIOLATION OF SECTION 13(b)(5)

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3 **JURY INSTRUCTION NO. [48] – SECTION 13(b)(5) CLAIM – ESSENTIAL ELEMENTS**

4 The SEC claims that the defendant knowingly falsified one or more of Embarcadero’s books,
5 records, or accounts described below. The SEC also claims that the defendant knowingly
6 circumvented or knowingly failed to implement a system of internal accounting controls.

7 To prove this claim, the SEC must show by a preponderance of the evidence that the
8 defendant knowingly either:

- 9 1. falsified any of Embarcadero’s books, records, or accounts that reflect the transactions and
10 disposition of Embarcadero’s assets; or
11 2. circumvented Embarcadero’s system of internal accounting controls; or
12 3. failed to implement a system of internal accounting controls at Embarcadero.

13 The terms “books, records, or accounts” mean accounts, correspondence, memoranda, tapes,
14 discs, papers, books, and other documents or transcribed information of any type, whether expressed
15 in ordinary or machine language. The SEC must prove that the book, record, or account does not, in
16 reasonable detail, accurately and fairly reflect the transactions and dispositions of the company’s
17 assets.

18 The phrase “system of internal accounting controls” means a system sufficient to provide
19 reasonable assurances that transactions are recorded as necessary to prepare financial statements that
20 conform to generally accepted accounting principles and to account for assets.

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23 Authority: 15 U.S.C. § 78m(b)(5) (providing that “[n]o person shall knowingly circumvent or
24 knowingly fail to implement a system of internal accounting controls or knowingly falsify any book,
25 record, or account described in paragraph (2)”); *id.* § 78m(b)(2) (providing that certain issuers “shall
26 – (A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly
27 reflect the transactions and dispositions of the assets of the issuer; (B) devise and maintain a system
28 of internal accounting records sufficient to provide [certain] reasonable assurances”); *id.* § 78c(37)

1 (defining records as “accounts, correspondence, memorandums, tapes, discs, papers, books, and
2 other documents or transcribed information of any type, whether expressed in ordinary or machine
3 language”).

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5 Court Comments: The parties have provided a stipulated instruction to which the Court has made
6 minor modifications.

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JURY INSTRUCTION NO. [49D] – SECTION 13(b)(5) CLAIM – FALSIFY

~~The SEC claims that the defendant violated Section 13(b)(5) by falsifying books, records, and accounts. In order for you to find the defendant liable for falsifying books, records, and accounts, the SEC must prove that each falsification was intentional, and not the result of errors or oversights.~~

~~Authority: 15 U.S.C. § 78m(b)(5) (providing that “[n]o person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2)”).~~

Court Comments: This instruction has been offered by the defendant only. The SEC argues that the instruction should not be included because Section 13(b)(2)(A) and Rule 13b2-1 do not require intentional conduct. However, this instruction deals with Section 13(b)(5), not Section 13(b)(2)(A) and Rule 13b2-1. On the other hand, the defendant’s instruction is not necessary because, given the above instruction on Section 13(b)(5), it is clear that the defendant must have acted knowingly.

**JURY INSTRUCTION NO. [50D] – SECTION 13(b)(5) CLAIM –
IMPLEMENTATION OF INTERNAL CONTROLS**

As stated in Instruction No. ____ above, the SEC claims that the defendant failed to implement a system of internal accounting controls. For all such claims, the SEC must also prove that:

1. The defendant was responsible for implementing such controls; and
2. If properly implemented, the controls would have prevented the claimed wrongdoing.

Authority: *SEC v. Cedric Kushner Promotions, Inc.*, 417 F. Supp. 2d 326, 337 (S.D.N.Y. 2006) (granting summary judgment to defendant on section 13(b)(2)(B) aider and abettor claim when plaintiff produced no evidence that defendant “was responsible for . . . maintaining adequate controls, or that he aided or abetted any violation with respect to [that] requirement[]”); *Marsden v. Select Med. Corp.*, No. Civ. A. 04-4020, 2006 U.S. Dist. LEXIS 16795, at *15 (E.D. Pa. Apr. 6, 2006) (granting motion to dismiss section 13(b)(2)(B) claim because “[p]laintiffs fail[ed] to connect the litany of alleged wrongdoings to any control or type of control that, if properly established, would have prevented the same”), *vacated in part on other grounds*, 2007 U.S. Dist. LEXIS 9893 (E.D. Pa. Feb. 6, 2007); *SEC v. Intelliquis Int’l, Inc.*, No. 2:02-CV-764 PGC, 2003 U.S. Dist. LEXIS 27131, at *13 (D. Utah Dec. 11, 2003) (granting summary judgment to SEC on section 13(b)(2)(B) aider and abettor claim where complaint adequately alleged primary violation, alleged that one defendant permitted company to record certain transactions as sales while knowing that they did not qualify as such, and alleged that second defendant, retained to audit financial statements, “essentially abandoned all responsibility for this job”).

Court Comments: An instruction has been offered by the defendant only. The SEC has not provided any argument against the instruction. A modified version of the defendant’s instruction is appropriate. The Court has eliminated the defendant’s proposed language on “devising” because even though Section 13(b)(2) refers to “devis[ing] and maintain[ing] a system of internal account controls,” 15 U.S.C. § 78m(b)(2), the instant case focuses on implementation (as reflected in the

1 prior instruction to which the parties stipulated). The Court also eliminated the defendant's
2 proposed language on "power" because nothing indicates that a defendant has to have had power as
3 opposed to just responsibility. See the case law cited above.

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VIOLATION OF RULE 13b2-1

**JURY INSTRUCTION NO. [51P & 51D] – RULE 13b2-1 CLAIM –
ESSENTIAL ELEMENTS**

The SEC claims that the defendant also violated Rule 13b2-1 of the Exchange Act. This rule prohibits anyone from falsifying any book, record, or account so that it does not, in reasonable detail, accurately and fairly reflect the transactions and the disposition of the assets of a company.

To prove this claim, the SEC must show by a preponderance of the evidence that the defendant, directly or indirectly, falsified, or caused to be falsified, any book, record, or account of Embarcadero such that it did not, in reasonable detail, accurately and fairly reflect the transactions and the disposition of Embarcadero’s assets.

The SEC need not prove that the defendant knowingly (as defined in Instruction No. ____) falsified or caused to be falsified any book, record, or account of Embarcadero. In addition, the SEC need not prove that the book, record, or account was materially (as defined in Instruction No. ____) false or inaccurate.

The terms “books, records, or accounts” are defined in Instruction No. ____ above.

Authority: 17 C.F.R. § 240.13b2-1 (providing that “[n]o person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A) of the Securities Exchange Act”); 15 U.S.C. § 78m(b)(2)(A) (providing that “[e]very issuer which has a class of securities registered pursuant to section 12 of this title [15 U.S.C. § 78l] and every issuer which is required to file reports pursuant to section 15(d) of this title [15 U.S.C. § 78o(d)] shall . . . make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer”).

Court Comments: Each party has submitted a proposed instruction. The parties have disagreements regarding (1) the issue of knowledge and (2) the issue of materiality.

1 With respect to knowledge, the SEC argues that Rule 13b2-1 does not require scienter while
2 the defendant argues to the contrary. The SEC is correct. In issuing the rule, the SEC made the
3 following comments regarding scienter:

4 Many comments expressed the view that a showing of
5 “scienter” ought to be required in order to establish violations of the
6 Rule. These comments were premised on the views that some false
7 entries in corporate books, records and accounts result from
8 inadvertent errors or oversights, and that a number of such entries are
9 inevitable, particularly in view of the volume of transactions that must
10 be recorded on a daily basis by large public companies. Some
11 comments added that it would be unfair to impose liability upon
12 persons who acted in good faith and made inadvertent or unintentional
13 mistakes.

14 After careful consideration of the comments, the Commission
15 has determined that a “scienter” requirement should not be included in
16 the Rule. The inclusion of such a requirement would be inconsistent
17 with the language of new section 13(b)(2)(A), which contains no
18 words indicating that the Congress intended to impose a “scienter”
19 requirement. It would be anomalous, under these circumstances, to
20 include a “scienter” requirement in the new Rule.

21 Moreover, the Commission believes that the concern expressed
22 with respect to inadvertent and inconsequential errors is unwarranted.
23 The statute does not require perfection but only that books, records
24 and accounts “in reasonable detail, accurately and fairly reflect the
25 transactions and dispositions of the assets of the issuer.” In addition,
26 the legislative history reflects that “standards of reasonableness” are to
27 be used in applying this provision.

28 SEC Release No. 34-15570, *available* at 1979 WL 173674, at *9-10 (Feb. 15, 1979).

Courts have accepted the SEC’s interpretation of Rule 13b2-1 as having no scienter
requirement. *See, e.g., McConville v. United States SEC*, 465 F.3d 780, 789 (7th Cir. 2006) (noting
that the SEC “has previously stated that there is no scienter requirement in SEC Rule 13b2-1
because § 13(b) of the 1934 Securities Exchange Act ‘contains no words indicating that Congress
intended to impose a “scienter” requirement’” and, “[a]s we have stated, the [SEC’s] interpretations
of its own regulations are entitled to deference as long as, as in this case, the interpretation is not
arbitrary, capricious, or manifestly contrary to the statute”); *SEC v. McNulty*, 137 F.3d 732, 740-41
(2d Cir. 1998) (stating that “the court’s ruling that lack of scienter would not be a defense to the
claims under § 13 and the regulations thereunder was consistent with precedent in this Circuit and

1 with the Commission’s interpretive regulations indicating that scienter is not an element of civil
2 claims under those provisions”).

3 As for the issue of materiality, the defendant does not dispute that Rule 13b2-1 does not
4 require that a falsity be material. The SEC has clearly interpreted the rule as not having a
5 materiality requirement. *See* SEC Release No. 34-15570, *available at* 1979 WL 173674, at *9
6 (addressing the concern of some advocates that there should be a materiality standard because
7 otherwise “false entries of insignificant or nominal amounts would give rise to a violation of the
8 rule”). According to the SEC, “the presence of the words ‘in reasonable detail’ in Section
9 13(b)(2)(A) should alleviate much of the concern,” and “[a] further consideration is the [SEC’s]
10 concern that a limitation concerning ‘material’ falsity would unduly narrow the scope of the rule and
11 result in an unwarranted diminution of investor protection.” *Id.* Given that materiality is not a
12 requirement under Rule 13b2-1 but is an element in so many of the other securities claims being
13 asserted by the SEC, it makes sense to clarify that, for this claim, there is no materiality requirement.

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1 **AIDING AND ABETTING VIOLATION OF SECTION 13(b)(2)(A)**

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3 **JURY INSTRUCTION NO. [52P & 52D] – AIDING AND ABETTING VIOLATION OF**

4 **13(b)(2)(A) – ESSENTIAL ELEMENTS**

5 The SEC claims that the defendant also aided and abetted Embarcadero’s violations of

6 Section 13(b)(2)(A) of the Exchange Act, which requires a public company such as Embarcadero to

7 make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect

8 the transactions and dispositions of the assets of the company. The terms “books, records, or

9 accounts” are defined in Instruction No. ____ above.

10 To prove that the defendant aided and abetted Embarcadero’s violation of Section

11 13(b)(2)(A), the SEC must establish by a preponderance of the evidence that:

- 12 1. Embarcadero failed to make or keep one or more if its books, records, or accounts in
- 13 reasonable detail, accurately and fairly reflecting the transactions and the dispositions of the
- 14 assets of a company (known as the “primary violation”);
- 15 2. the defendant had actual knowledge of both the primary violation and of his role in
- 16 furthering it; and
- 17 3. the defendant provided substantial assistance in the primary violation.

18 The SEC need not prove that Embarcadero knowingly (as defined in Instruction No. ____)

19 falsified or caused to be falsified any of its books, records, or accounts. In addition, the SEC need

20 not prove that the book, record, or account was materially (as defined in Instruction No. ____) false

21 or inaccurate.

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23 Court Comments: The analysis with respect to the above instruction is applicable here as well.

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1 **AIDING AND ABETTING VIOLATION OF SECTION 13(b)(2)(B)**

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3 **JURY INSTRUCTION NO. [53P & 53D] – AIDING AND ABETTING VIOLATION OF**

4 **13(b)(2)(B) – ESSENTIAL ELEMENTS**

5 The SEC’s last claim against the defendant is that he aided and abetted Embarcadero’s

6 violation of Section 13(b)(2)(B) of the Exchange Act. This claim is similar to the SEC’s Section

7 13(b)(5) claim, only here you must decide whether the defendant aided and abetted Embarcadero’s

8 violation, and not whether the defendant directly failed to maintain a reasonable system of

9 accounting controls.

10 As I mentioned, the Exchange Act requires that companies devise and maintain a system of

11 internal accounting controls to provide reasonable assurances that transactions are executed in

12 accordance with management’s authorization; that all transactions are recorded as necessary to

13 permit preparation of financial statements in conformity with generally accepted accounting

14 principles or any other criteria applicable to such statements; and to maintain accountability for

15 assets.

16 To prove that the defendant aided and abetted Embarcadero’s violation of Section

17 13(b)(2)(B), the SEC must establish by a preponderance of the evidence that:

- 18 1. Embarcadero failed to devise and maintain reasonable accounting controls (known as the
- 19 “primary violation”);
- 20 2. the defendant had actual knowledge of both the primary violation and of his role in
- 21 furthering it; and
- 22 3. the defendant provided substantial assistance in the primary violation.

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24 Court Comments: The main dispute between the parties is whether or not to include language

25 indicating that Embarcadero’s primary violation must have been committed by someone other than

26 the defendant. For reasons stated earlier, the Court concludes it does not.

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JURY INSTRUCTION NO. [54D] – WILLFULLY

~~An act is done willfully if it is done voluntarily and intentionally and with the purpose of violating a known legal duty. In other words, in the context of each count, the SEC must prove that Mr. Pattison undertook an act he knew to be wrongful. Willfully means intentionally undertaking an act that one knows to be wrongful.~~

Court Comments: This instruction has been offered by the defendant only. Willfulness does not appear to be an issue. As indicated above, for the securities claims where scienter is required, all that is necessary is “knowing” conduct (which includes recklessness).

The Court notes that, in the defendant’s memo, he states that “Plaintiff withdraws this proposed jury instruction.” Def.’s Memo. at 23. The Court assumes the defendant meant to say that *he* (as opposed to the SEC) withdrew the instruction.